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IN THE

Supreme Court of the United States

October Term, 1955

No. 194

ADELINE KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA,

Respondent.

HENRY KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONERS IN REPLY.

Argument.

1. Respondent's argument, as the decisions of the Courts below, is based on three major fallacies, namely (a) that petitioners *retained* control of the subject property; (b) that the amount of the rent paid in 1944 to petitioners' daughter was specified in the lease in terms

of dollars to be $19,412.54, and (c) that the rent paid in 1944 in the sum of $19,412.54 was not ordinary and necessary solely because petitioners could have refrained from purchasing the property and thus continued to operated under the Osborne lease.

(a) Respondent states that the transaction, *i. e.*, the gift and the lease back, merely shifted a portion of the petitioners' income to the daughter "while *leaving* intact their effective control over the donated property." (Emphasis added.) This is an erroneous statement. From the moment of the gift until the execution of the lease, after the Court had approved its execution, petitioners were left with no control, effective or otherwise, over the subject property. Upon the execution of the lease, and not otherwise, petitioners *regained* possession and control of the property, subject to the burden of paying rent based on the *share-crop formula* specified in the lease.

The gift and the lease-back in the instant case left intact petitioners' effective control over the donated property to no greater or lesser extent than the taxpayers were left with such control in *Skemp v. Commissioner*, 168 F. 2d 598 (C. C. A. 7, 1948), and *Brown v. Commissioner*, 180 F. 2d 926 (C. C. A. 3, 1950), cert. den. Oct. 9, 1950, 340 U. S. 814, 71 S. Ct. 42. With respect to whether petitioners retained or regained control of the donated property, the instant case *cannot* be distinguished from *Skemp v. Commissioner, supra*, and *Brown v. Commissioner, supra*.

Respondent relies heavily on *White v. Fitzpatrick*, 193 F. 2d 398 (C. C. A. 2, 1951), cert. den. 343 U. S. 928. The *White* case is clearly distinguishable on the facts. Indeed the Court in the *White* case distinguished

it from the *Skemp* and the *Brown* cases and approved the decisions in said cases. The Court in the *White* case, at 401, in speaking of the *Skemp* and *Brown* cases, said:

> "In upholding the deductions, both courts expressly emphasized the independence of the trustees. It is probable that a like result would probably have obtained had the question been one of gross income under I. R. C., Sec. 22(a). For three factors determine attributability of income to the settlor of a family trust. Whether these are conjunctive tests, see Helvering v. Clifford, *supra,* 309 U. S. at page 335, 60 S. Ct. 554, or alternative, under the new Clifford regulations, U. S. Treas. Reg. No. 111, Sec. 29.22(a)-21; Kay v. C. I. R., 3 Cir., 178 F. 2d 772, it seems likely that in both the cases relied on, income would have been attributable to the trusts and thus to the beneficiaries, rather than the settlors. For (1) the settlors retained no reversionary interests; (2) they retained no dispositive power over either corpus or income; and (3) administrative control was not exercisable primarily for the benefit of the settlors."

In a footnote, page 401, the Court noted that in the *Skemp* case the taxpayer reserved the right to rent the donated property, and said

> "but this does not constitute 'beneficial enjoyment' of the property in the Clifford[1] sense."

In the *White* case, one of the gifts was of a patent "to the full end of the term of said patent." and the license back was "to the full end of the entire term of said

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[1]*Helvering v. Clifford,* 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788.

patent." Of this the Court, in further reference to the *Skemp* and *Brown* cases, in the footnote on page 401, said:

> "Moreover, both leases back were for a term and were not coextensive with the life of the trust."

And in a footnote on page 402, the Court said:

> "Here the factor of independent trusteeship is crucial, and it is in this respect that the instant case differs on its facts from the Skemp and Brown results."

The *White* case differs on its facts from the instant case in the same respects as it differs from the *Skemp* and *Brown* cases.

Here, as in *Skemp* and *Brown*, an independent new owner came into being—a guardian, acting under the authority, control and jurisdiction of an independent Court of California, here, as there, the lease was for a term and not coextensive with the full life of the property or of the guardianship.

(b) Respondent, as did the Courts below, erroneously interprets the lease as one for the payment of rent in the specified sum of $19,412.54 for the year 1944. The Court of Appeals said [R. 173; Pet. App. 4]:

> ". . . instead, by their own contrivance, they *elected* to pay $19,412.54." (Emphasis added.)

Petitioners did not "elect" to pay a single penny as rent. They merely agreed to pay certain fractions of the gross harvest of the crop based on the market price of the crop. Had there been a complete crop failure so that there would have been no harvest, could it be said that petitioners by their own contrivance, elected to pay no rent. The amount of the rent in the sum of $19,412.54

actually paid in 1944 was a result, not an election. It was the result of a good crop bringing a high market price. [R. 98, 139-143; Pet. 13-14.] The rent paid was based on a formula that was in conformity with share crop leases than in general use in Kern County [R. 76; Pet. 13], and hence was of necessity reasonable. [Pet. 13; R. 98-99.]

(c) Respondent argues, as the Courts below determined, that the rent paid by petitioners was not ordinary and necessary solely because petitioners could have refrained from using permissible business judgment, not purchased the subject property and hence continued to farm the property under the Osborne lease and pay the rent therein called for. (Resp. Br. 12-15.) Such argument ignores the fact that petitioners purchased the subject property in August, 1943, and hence the Osborne lease was merged into the superior title and vanished. It follows that Respondent's argument boils down to a statement that Petitioners were barred by law from exercising permissible business judgment and likewise barred from purchasing the property. Certainly such is not the law. A taxpayer may choose any form of doing business he desires even if his reason for choosing the particular form is to minimize taxes.

United States v. Cumberland Public Service Co., 338 U. S. 451.

The Osborne lease has no bearing in the instant case, for the reason that it was superseded by the purchase of the property in 1943, and was not in existence in 1944 and hence the Petitioners could not have farmed under it.

Further, the two leases were entirely different. The Osborne lease was a development lease, the Shirley May

lease was an agricultural lease. The former provided for a straight cash rental, the latter a contingent share crop or percentage rental. [Pet. 13.]

Exactly the same situation existed in *Brown v. Commissioner,* 180 F. 2d 926. There the taxpayers rented a railroad siding in their mining operations. They paid as rent $2.50 a car regardless of the amount of coal loaded. The siding was capable of holding 30 coal cars. Hence, the rental for a full 30-car use of the siding was $75.00. Each coal car held from 50 to 70 tons, or an average of say 60 tons. Taxpayers purchased the property, made a gift of it to a trust for the benefit of their children and leased it back agreeing to pay 7 cents a ton of coal loaded and agreed to keep the siding in good repair at their own expense. Hence the rental for a full 30-car use of the siding was $126.00 (30 cars x 60 tons x 7 cents).

Respondent's argument that the rent paid by Petitioners in 1944 was not ordinary or reasonable because of Petitioners' purchasing the property, thus superseding the Osborne lease, then making the gift and lease-back, is the same argument that he made in the *Skemp* case, namely, that Petitioners voluntarily created the then present situation. The answer given by the Court in the *Skemp* case, page 600, is equally applicable here:

> "The trustee was duty bound to exact rent of the taxpayer and the taxpayer was legally bound to pay it, just as much as if taxpayer had moved across the street into the property of a third party. No one doubts that he would have had to pay rent then, and would have been entitled to deduct it even though he had voluntarily created that situation.

> We are not impressed with the argument of the government that the taxpayer voluntarily created the present situation."

The rent paid by Petitioner herein in 1944 was just as ordinary and necessary as it was in the *Skemp* and *Brown* cases, *supra.*

2. Not only is the instant case in direct conflict with *Skemp v. Commissioner,* 168 F. 2d 598 (C. C. A. 7), and *Brown v. Commissioner,* 180 F. 2d 926 (C. C. A. 3), but it is equally in conflict with *Commissioner v. Greenspun,* 156 F. 2d 97 (C. C. A. 5), *Consolidated Apparel Co. v. Commissioner,* 207 F. 2d 580 (C. C. A. 7), *Stearns Magnetic Mfg. Co. v. Commissioner,* 208 F. 2d 849 (C. C. A. 7), and the Tax Court's decision in *Albert T. Felix,* 21 T. C. 794. In the latter case, the Tax Court, page 803, treats of each of the main cases cited by Respondent (Resp. Br. 12) and distinguishes each of them. The Tax Court then turned its attention to the *Skemp* and *Brown* cases. The Tax Court had decided both the *Skemp* and the *Brown* cases in favor of the Commissioner and had been reversed in each. The Court then says at 804:

> "We think the case at bar is not readily distinguishable from the *Skemp* and *Brown* cases, *supra.* Accordingly, we adopt the view expressed by the appellate courts and hold that the rental payments constitute ordinary and necessary business expenses. . . ."

Thus, the Tax Court has fallen into agreement with the Third, Fifth and Seventh Circuits, leaving only the Ninth Circuit in the instant case in disagreement. The same distinction which the Seventh Circuit made in *Ingle*

Coal Corp. v. Commissioner, 174 F. 2d 569, 572 (Resp. Br. 16), is equally applicable here. In the instant case, as in *Skemp* and *Brown,* the taxpayers transferred the property to an independent fiduciary acting under the authority, control and jurisdiction of an independent court, taxpayers retained no control and consequently "there was a change in the taxpayer's economic status."

3. It is submitted that there has been "very exceptional showing of error" in the instant matter.

Conclusion.

For the reasons set forth in the petition and herein, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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